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SUBJECT: The Japan Economic Scope June 28, 2007

Sensitive but unclassified. Please protect accordingly.

¶1. (U) This cable contains the Japan Economic Scope from June 28, 2007.

## 2. (SBU) Table of Contents

¶13. Economic Section's Thinning Ranks  
¶14. Doha Stock Taking in Tokyo  
¶15. Ag Text Delay -- Is There a Silver Lining?  
¶16. US-Korea FTA -- Political Will Key to Deal  
¶17. U.S. Beef: Technical Talks in Tokyo  
¶18. Japan's First Rice Exports to China Begin  
¶19. Japan Helps Fund WTO Training Program  
¶110. TSE to Introduce Japan Depositary Receipts  
¶111. Share Wars: The Company Strikes Back  
¶112. NikkoCitigroup's Fujita on Triangular Mergers  
¶113. Cabinet Office Releases Study Group Report: Stronger Action Against Competition Law Offenders  
¶114. USJ Cuts Out Osaka City from Its Management Structure  
¶115. Ambassador at NWA 60th Anniversary of Serving Japan  
¶116. KIX Must Wait to Become 24-Hour Airport  
¶117. Toward "Car Electronics Island Kyushu"  
¶118. Honda Motors on U.S.-Japan Auto Relations and Environment  
¶119. Former Prime Minister Miyazawa Dead at 87  
¶120. Igawa is Back and Looking Good  
¶121. But Matsuzaka Even Better!  
¶122. Hotdog Giant Out of Action?

## ¶13. (U) Economic Section's Thinning Ranks

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It is that time of the year. This week Hans Klemm, who has been the Embassy's Economics Minister since last August, departed post to become Ambassador to East Timor -- although, for the record, we only have confirmation that he departed on a flight to Bali on June 26. Hans will be replaced by Robert Cekuta, who arrives in August.

Ambassador Klemm left his mark on the section by pushing for a more robust bilateral engagement and to have an FTA on the agenda, keeping his focus on the big picture.

Three other key figures are set to depart soon. Masumi Ono, Economic Assistant and invaluable member of the section, will finish her tour on June 29, before returning to New York to resume her UN career. (Her husband, Brett Blackshaw will move from the Political Section to the Vietnam desk.)

Ono-sama has been our reg ref specialist since arriving at post three years ago as well as our ace on special zones, and large scale retail development among other issues. She will be succeeded by Eriko Marks who is already on board.

Dan Fantozzi, currently Acting EMIN, and Marilyn Ereshefsky, our IT and telecoms point person, will be departing Tokyo July 19 and 25, respectively. Three years in the Section, Dan has proven more than anything else that he is irreplaceable. He will be heading back to Main State, although, we hope, not before leaving some of his wisdom on civair and postal privatization matters behind. He will be Director for Environmental Policy in OES. Marilyn, who grasped some complicated portfolios that left others flummoxed or catatonic, will be heading back to Washington as an American Political Science Association (APSA) Congressional Fellow. She will spend the fall at SAIS and the spring on Capitol Hill. Marilyn will be succeeded by Scott Smith, who arrives in late July. (ECON: Nicholas Hill)

14. (SBU) Doha Stock Taking in Tokyo

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After the collapse last week of the G-4 talks in Potsdam to move the Doha Trade Round forward, Japan's Agriculture and Trade Ministers issued a joint statement pledging to "participate actively" in any consultations to bring the Round to a successful conclusion.

Trade Minister Amari told reporters on June 26 that he hoped to gather a number of developing countries that can be flexible in the NAMA talks on the margins of APEC meetings in early July in Australia. (Before then he will be traveling to India primarily

TOKYO 00002966 002 OF 008

to discuss bilateral issues, including energy cooperation.)

In Tokyo on June 25, Vice Trade Minister Toshiaki Kitamura expressed his disappointment with the stalled Doha talks during a meeting with the EMIN. Other sources at the Trade Ministry and Foreign Ministry were trying to piece together what had happened in Potsdam.

The officials were interested in how committed the United States remained to the Doha process and how effectively WTO Director General Lamy could jump start negotiations after NAMA and Agriculture Committee Chairs deliver their texts in coming weeks.

We underscored the continued priority the United States attaches to a successful conclusion of the Doha Round, although noted that a bad deal is worse than no deal at all. (ECON: Nicholas Hill)

15. (SBU) Ag Text Delay -- Is There a Silver Lining?

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The Japan Agriculture News noted on June 27 that WTO Agriculture Committee Chair Falconer was already running into some difficulties with key members and the release of his draft text would likely be delayed.

According to the article, the G-4 countries are still using the media to blame others for the collapse of talks in Potsdam on June 21.

An economist at a leading bank in Tokyo we talked to on June 26 told us he was surprised that the Potsdam talks failed, but pointed to a possible silver lining. Given PM Abe's declining popularity and the late July upper house elections, the government would be in a better position to take difficult decisions after the voting is over.

If Falconer's paper on modalities, he continued, is issued on time -- which is to say as early as July 2 -- it would be difficult

for Japan, because of the elections and an inexperienced Agriculture Minister, to make tough decisions before the voters

go to the polls.

Japan, he added, would be put in a very difficult situation if Korea, with a similarly protectionist-minded farm lobby, suddenly decided to compromise in the agriculture talks. (ECON: Nicholas Hill/Ryoko Nakano)

16. (U) US-Korea FTA -- Political Will Key to Deal

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Political leadership made the U.S.--Korea Free Trade Agreement (KORUS) possible. That was the message underscored by Ahn Se-Young, a professor at Korea's Sogang University, during a brown bag Trade Ministry-sponsored conference in Tokyo on June 26. Ahn described the political courage demonstrated by South Korean president Roh Moo-hyun, who stood up against some traditional political backers to bring the talks to a successful conclusion; even at one point firing his Agriculture Minister over some negative remarks the minister had made.

Moderating the METI event was Waseda University economics Professor Shujiro Urata. Also the chair of a working group to promote a more liberal trade regime under the Prime Minister's Council on Economic and Fiscal Policy, Urata credited Roh for his political leadership, but suggested it would be more difficult for Japan, under a parliamentary system, to follow a similar course.

Urata conceded that Japan has not traditionally pushed for ambitious Free Trade Agreements, including in the negotiations that Japan launched with Korea -- talks which Korea suspended before launching its FTA round with the United States.

When an official in the audience from Tokyo's European Commission Office expressed concern that KORUS faces an uphill battle in the U.S. Congress, Ahn did not seem overly concerned about ratification. He noted that Congress tends to fixate on environmental aspects of FTAs; CAFTA, he predicted, posed bigger concerns for Congress than KORUS.

TOKYO 00002966 003 OF 008

A reporter for the New York Times asked what benefits would accrue to North Korea's industrial complex in Kaesong as a result of the deal. Ahn said that, regardless of the attention to this issue, in reality Kaesong was of limited economic interest to South Korean companies. For the presentation sheet, click [here](#).  
(ECON: Nicholas Hill/Ryoko Nakano)

17. (SBU) U.S. Beef: Technical Talks in Tokyo

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U.S. technical experts sat down with their Japanese government counterparts in Tokyo June 27-29 in the first set of talks to discuss BSE data that was behind the decision by the World Animal Health Organization (OIE) to place the United States in a "controlled risk" category that should ease tight restrictions on U.S. beef exports to Japan.

Japanese officials have told us that the talks may require up to two to three rounds before the government can send a recommendation to the independent Food Safety Commission on whether to ease the currently onerous restrictions that have slashed dramatically U.S. beef sales in Japan.

We will have more reporting on the meetings next week after they have concluded. (ECON: Nicholas Hill)

18. (U) Japan's First Rice Exports to China Begin

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The first cargo of Japan's exports of rice to China departed on June 24. The shipment is the first since Prime Minister Wen Jiabao and Prime Minister Shinzo Abe agreed to resume exports in April.

Exports to China had been stalled since 2003 when China had reviewed its quarantine system. According to reports, the shipment will be directed to Beijing and Shanghai and arrive sometime in mid-July.

The shipper of the cargo, the Japan Agriculture Cooperatives, hopes the Chinese market will prove lucrative. Japanese rice is considerably more expensive than locally grown Chinese rice -- or, for that matter, virtually any rice in the world. Agriculture Ministry officials hope that the agreement will contribute to the government's goal of tripling food exports by 2013.

To commemorate the occasion, the Ministry of Agriculture will hold a reception on June 29 in Tokyo. (ECON: Nicholas Hill/Ryoko Nakano)

#### 19. (U) Japan Helps Fund WTO Training Program

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Japan just donated over \$400,000 to its WTO Development Agenda Global Trust Fund, which finances technical assistance programs and training activities for developing and least developed countries as well as economies in transition. (ECON: Ryoko Nakano)

#### 110. (U) TSE to Introduce Japan Depositary Receipts

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The Tokyo Stock Exchange (TSE) plans to introduce a system of Japanese Depositary Receipts (JDRs) starting in September 2007. The new system will provide a way for foreign companies to access the Japanese capital market without listing their shares directly.

The proposal is part of the effort to turn Tokyo into a global financial center. Because JDRs will be domestic securities and denominated in yen, they could be easier for Japanese shareholders to understand and therefore may be an attractive option for foreign firms considering a triangular merger. For more information, see Tokyo 2946, (ECON: David DiGiovanna)

#### 111. (U) Share Wars: The Company Strikes Back

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At a June 24 general shareholders meeting, Bull-Dog Sauce co. shareholders approved the introduction and implementation of

TOKYO 00002966 004 OF 008

defensive measures that would allow the company to issue 3:1 share warrants to existing shareholders thereby diluting the holdings of the firm's largest shareholder, U.S. hedge fund Steel Partners.

This was the fund's third loss in three days. Inaba Denki Sangyo and Brother Industries both dismissed Steel Partner's shareholder proposals for large dividend hikes at shareholder meetings on June 22. Other companies in which the fund is a leading shareholder, including Sansei Yusoki and Chuo Warehouse, are also considering the introduction of defensive measures at upcoming shareholders meetings.

Steel Partners suit seeking to block Bull-Dog from going forward with the warrant plan was rejected by Tokyo District Court on June 28. Steel Partners is presumed to immediately appeal to Tokyo High Court. (ECON: Satoshi Hattori)

#### 112. (U) NikkoCitigroup's Fujita on Triangular Mergers

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Top Japanese Equity Strategist and M&A Expert Tsutomu Fujita of NikkoCitigroup, headlined a seminar on Japan's new Triangular Merger Law on June 26.

From his study of global trends, Fujita observed that most M&A's that use shares as consideration are large scale, high value

transactions (usually more than three trillion yen).

Since the market capitalization of most Japanese target companies is relatively small, Fujita believes few foreign companies would be interested in using Japan's triangular merger provisions.

Fujita also explained the difference between the Japanese and U.S. triangular merger provisions.

Japan's Corporate Code only allows "forward" triangular mergers in which the subsidiary of the acquiring company becomes the surviving company.

Conversely in the United States, most triangular mergers are "reverse" triangular mergers, in which the target company becomes the surviving company, and the exchange agent mediates by issuing American Depository Shares (ADS) to the target shareholders (which Fujita referred to as a "rectangular merger"). This allows the surviving company to retain all approvals and licenses held before the merger.

In addition, the presence of the exchange agent enables European companies to conduct cross-border triangular mergers, since European commercial law, in principle, does not allow the subsidiary to hold the shares of its parent company (although exceptions do exist). Fujita therefore believes the Japanese triangular merger is not suitable for European companies and will be used entirely by U.S. companies.

Furthermore, he pointed out that in the United States the subsidiary vehicle company is normally a Special Purpose Vehicle company established simply for the purpose of the merger. Japanese triangular merger provisions, on the other hand, require the acquiring company subsidiary to engage in business operations in order for the transaction to receive tax deferral. This is an additional burden for foreign companies conducting triangular mergers in Japan.

In Fujita's conclusion, he stated that the Japanese triangular merger scheme is significantly inconvenient, and believes cross-border triangular merger transactions will not occur frequently in Japan. Such transactions, if any, would be conducted mainly by United States companies. (ECON: Satoshi Hattori)

¶13. (SBU) Cabinet Office Releases Study Group Report: Stronger Action Against Competition Law Offenders

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On June 26, the Cabinet Office released a report by the Study Group on Basic Issues in the Antimonopoly Act, calling for increased punitive surcharges on companies found to have engaged in cartels or bid-rigging conspiracies, particularly those firms with a leading role in the illegal action. The report, however, avoided designating a specific surcharge level.

TOKYO 00002966 005 OF 008

The Study Group also recommended maintaining both administrative surcharges and criminal penalties for violations of the Antimonopoly Act, a situation the Japan Business Federation (Keidanren) had characterized as contradictory to the prohibition on "double jeopardy" in the Japanese Constitution.

Similarly, the Study Group rejected Keidanren's request to eliminate the system under which the Japan Fair Trade Commission (JFTC) hears the appeals of companies contesting surcharge orders levied by the JFTC itself instead of referring the case directly to the judicial system for review.

The release of the Study Group report -- the product of 35 meetings held over the past two years-- sets the political stage for possible new amendments to the Antimonopoly Act when it is reviewed by the Diet at the session beginning in January 2008. (ECON: Chris Wurzel)

¶14. (U) USJ Cuts Out Osaka City from Its Management Structure

Universal Studios Japan (USJ) unofficially announced that their board of directors would no longer contain any Osaka city government officials. A formal statement will be made after the general meeting of stockholders on June 27.

USJ was established as a third sector organization by the Osaka city government in 1996, and this marks the first time city officials will not occupy any executive director positions. Executives from Universal Studios U.S., Goldman Sachs, Japanese private companies, and financial institutions will make up the new management structure.

A USJ sales manager pointed out that after Glenn Gumpel replaced an Osaka city government official as the president of USJ, the city's influence over management issues has declined.

In addition, USJ has acted more independently since being listed as a private company on the "Mothers" section of the Tokyo Stock Exchange in March 2007.

No longer obligated to confer with the Osaka city government, the sales manager predicts that USJ will be able to accelerate its decision-making process. (Osaka-Kobe: Phil Cummings/Scott Ravenhill/Naomi Shibui)

**¶115. (U) Ambassador at NWA 60th Anniversary of Serving Japan (U)**  
On June 26, Ambassador Schieffer made the kampai toast and broke open the sake barrel with several Northwest Airlines senior executives at a large reception in Tokyo commemorating NWA 60 years of scheduled service to Japan.

Northwest executives told the crowd, which included industry leaders, such as the President of Boeing Japan, that the airline had been a leader in Pacific aviation and had worked hard to strengthen its connections to Japan.

On Sunday, July 20, 1947, a Northwest Airlines Douglas DC-4 touched down at Haneda Airport after some 50 hours of travel. Originating in La Guardia in New York City, the flight inaugurated Northwest's regular service to Japan.

It also marked the start of Northwest's regular service to Asia as many of the passengers continued on to Shanghai and Manila. Northwest was the first U.S. airline to operate an all-jet fleet across the Pacific. The airline helped establish Japan Airlines in 1951 by leasing NWA aircraft and crew to the company. (ECON: Josh Handler)

**¶116. (SBU) KIX Must Wait to Become 24-Hour Airport**

The Ministry of Land, Infrastructure, and Transportation (MLIT) announced on June 21 that due to a delay in the construction of the air traffic control system for the second runway at KIX, which opens on August 2, the new runway will not be operational during evening hours until construction can be completed in October.

Currently, KIX must shut down a few hours at night to perform

TOKYO 00002966 006 OF 008

daily maintenance on its sole runway. A second runway will give KIX at least one open runway at all times.

Kansai International Airport Co., Ltd. (KIAC) was disappointed by the MLIT statement because they had counted on the second runway to transform KIX into a true 24-hour airport.

The delay, moreover, will jeopardize KIX's chances of attaining its target of 130,000 flights for the year. KIX must meet this goal to receive financial support from MLIT for the second runway project. (Osaka-Kobe: Phil Cummings/Scott Ravenhill/Naomi Shibui)

¶17. (U) Toward "Car Electronics Island Kyushu"(U)

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As electronics play an increasingly important role in automobiles, hybrid cars in particular, semiconductor (IC) manufacturers operating in Kyushu (e.g., NEC, Renesas Technology, Mitsubishi Electric, and Toshiba) are expanding production capacity to meet this growing demand.

Kyushu currently accounts for 23 percent of Japan's IC production and nearly 10 percent of Japan's auto production.

According to the Kyushu Branch of the Development Bank of Japan, the potential car electronics market in Kyushu is worth about five billion dollars.

With Toyota, Nissan, and Daihatsu's total production capacity in Kyushu expected to reach 1.5 million units per year by 2009, there is also an increasing demand for skilled workers to develop these value-added car parts.

In response to this challenge and as part of a METI-funded program, the Kitakyushu Foundation for the Advancement of Industry Science and Technology (FAIS) plans to offer post-graduate courses on car electronics, starting as early as 2009. These courses will be conducted in collaboration with three universities (Kyushu Institute of Technology, the University of Kitakyushu, and Waseda University) as well as auto and electronics manufacturers.

FAIS expects to train about 60 car electronics specialists annually through this program. (Fukuoka: Yuko Nagatomo/James Crow)

¶18. (SBU) Honda Motors on U.S.-Japan Auto Relations and Environment

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Honda motors representatives shared their views on the U.S.-Japan auto relationship and environmental questions with us on June 25.

On the weak yen issues in the news, Honda disavowed any connection to their production plans as Honda's consistent philosophy is to produce in locations close to its customers. They noted 80 percent of the Honda cars sold in the United States are manufactured in North America.

Asked if Honda had ever considered a plant in Michigan, they had a vague recollection that when Honda was first considering a plant in the late 1970s and early 1980s, Michigan was not interested, so that is one of the reasons Honda's first auto plant was in Ohio.

After that Honda made its plant location decisions based on Honda's production needs and the workforce, and so plants ended-up elsewhere than Michigan. The reps spoke very highly, however, of the governor of Michigan.

On the hot-topic of global warming and fuel efficiency, they noted that Honda was not part of the automaker's fight against tighter fuel efficiency standards in the United States. Honda is pursuing several technologies for improving mileage and reducing emissions: hybrids, fuel cells, clean-diesel, flex-fuel engines and fuel cells.

As for gasohol and Japan, they intimated that Japan is unlikely to have a large supply of ethanol in the near future, but if for some reason a large supply becomes available Honda could make use

TOKYO 00002966 007 OF 008

of its flex-fuel technology engines used in Honda's Brazilian production.

They conceded bio-diesel fuel might hold some promise, but Honda is not selling passenger diesels in Japan.

The Honda reps said it will take some tax incentives to introduce clean-diesel technology as diesel has a dirty image in Japan, but Honda is selling clean diesel vehicles in Europe. They noted that Mercedes is selling one clean-diesel car in Japan, but that it will probably not turn public perceptions around. (ECON: Josh Handler/Junko Nagahama)

119. (U) Former Prime Minister Miyazawa Dead at 87

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Former Prime Minister (1991-93) Kiichi Miyazawa died June 28 in Tokyo at the age of 87.

One of Japan's longest serving statesmen, Miyazawa came from a family of prominent politicians. His father was a member of the Diet and his grandfather was a Cabinet minister. One brother was a one-time governor and another ambassador. Miyazawa also was related through marriage to two former prime ministers.

In addition to becoming Prime Minister himself, Miyazawa held a number of Cabinet posts, including two stints as Finance Minister (1986-88 and 1998-2001), Chief Cabinet Secretary (1980-82), Minister of Foreign Affairs (1974-76) and Minister of International Trade and Industry (1970-71).

First elected to the Diet Upper House in 1953, Miyazawa was a founding member of the Liberal Democratic Party in 1955. He won a seat in the more powerful Lower House in 1967. A great friend of the United States, he worked as an interpreter in the General Headquarters of the Occupation forces, attended the San Francisco Peace Conference in 1951, and accompanied then Prime Minister Hayato Ikeda when he met President John F. Kennedy in 1961.

Miyazawa was chosen for membership on the Trilateral Commission in 1973. As Prime Minister, Miyazawa attended the Summit Meeting of the U.N. Security Council in New York where he also met with then President George Bush, Russian President Boris Yeltsin, British Prime Minister John Major and Chinese Premier Li Peng.

Miyazawa was educated at the prestigious Tokyo University, and later joined the Finance Ministry. An avid student of English, he is said to have eaten an entire concise English-Japanese dictionary, following a custom of literally eating the words once they were memorized. Miyazawa's daughter is married to U.S. Ambassador to Malaysia Christopher LaFleur. (ECON: Joan Siegel)

120. (U) Igawa is Back and Looking Good

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New York Yankees off-season pitching upgrade, Kei Igawa, returned to the line-up June 22 for the first time since May 5. Igawa pitched 4 2/3 strong innings giving up two runs on five hits, walking two and striking out five, including Barry Bonds on three pitches before a sellout crowd of 43,500 at San Francisco's bayside AT&T Park.

Although Igawa got into trouble in the 5th, giving up three hits and two walks before Skipper Joe Torre pulled him, his placement was much improved from April and he was able to keep the ball down and inside. Clearly the work with Yankee pitching coaches in Tampa and Scranton has paid off. If he can maintain this form through the summer, he could make a solid contribution to the still rickety Bronx pitching staff. (ECON: David DiGiovanna)

121. (U) But Matsuzaka Even Better!

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The great Red Sox right hander captivated Japanese viewers on nationwide television June 28 during the morning drive time. Daisuke Matsuzaka pitched a brilliant eight innings, giving up only one run, and struck out a lot of batters.

Regrettably, the once lowly Seattle Mariners took three straight games from the Major League's best team, with centerfielder Ichiro Suzuki performing brilliantly, including scoring all the

way from first base to win the final game of the series.

Earlier in the week, Matsuzaka out-dueled future Hall of Famer Gary Maddux to win his ninth game of the season, 2-1, over the San Diego Padres. Reliever Hideki Okajima also continued to put in a number of scoreless relief stints for Boston. (ECON: Nicholas Hill)

**122. (U) Hotdog Giant Out of Action?**

Coney Island may not get the same attention in Japanese media outlets this Fourth of July. The best poster boy for U.S. beef byproducts from cows over 20 months old may be on the sidelines.

Takeru Kobayashi is to hotdog eating contests what Napoleon Bonaparte was to the creation of the nation state -- or Franz Kafka was to the writing of dull books -- a legend that towers over his peers.

The sport of eating hotdogs fast used to be the domain of corpulent American men -- men who would pour mustard and ketchup and relish on their dogs, float them into their mouths, and savor each bite, all with a big smile on their face.

Kobayashi, a skinny ascetic from Japan -- albeit, one who doffs his baseball cap to one side -- changed everything when he showed up one Fourth of July seven years ago at Nathan's on Coney Island.

From an expression of hedonism, he turned eating hotdogs into a martial art form.

Looked on with disdain initially by his rotund rivals, Kobayashi had no time to enjoy the hotdog. In contests, he would take the bun, dip it in water, crunch it down with his hands into a small pellet, then use the hotdog as a plunger to force the bread down his throat. The hotdog followed, with breathtaking minimalism -- Kobayashi chewed only if he had to.

And the diminutive Japanese kept winning hotdog eating contests, six in a row so far. But this year his streak on Coney Island may be about to end. "My jaw refused to fight anymore," he said forlornly on his website. (ECON: Nicholas Hill)

SCHIEFFER